accrues and deducts for such year. In 1968 Z pays the $80. Section 461(f) does not apply to Z with respect to the transfer because a contest did not exist after the time of such transfer.

(e) *Deduction otherwise allowed*—(1) *In general.* The existence of the contest with respect to an asserted liability must prevent (without regard to section 461(f)) and be the only factor preventing a deduction for the taxable year of the transfer (or, in the case of an accrual method taxpayer, for an earlier taxable year for which such amount would be accruable) to provide for the satisfaction of such liability. Nothing in section 461(f) or this section shall be construed to give rise to a deduction since section 461(f) and this section relate only to the timing of deductions which are otherwise allowable under the Code.

(2) *Example.* The provisions of this paragraph are illustrated by the following example:

Example. A, an individual, makes a gift of certain property to B, an individual. A pays the entire amount of gift tax assessed against him but contests his liability for such tax. Section 275(a)(3) provides that gift taxes are not deductible. A does not satisfy the requirement of paragraph (a)(1)(iv) of this section since a deduction would not be allowed for the taxable year of the transfer even if A did not contest his liability for such tax.

(f) *Treatment of money or property transferred to an escrowee, trustee, or court and treatment of any income attributable thereto.* [Reserved]

(g) *Effective dates.* Paragraphs (a) through (e) of this section apply to transfers of money or property made in taxable years beginning after December 31, 1953, and ending after August 16, 1954.

[T.D. 6772, 29 FR 15753, Nov. 24, 1964, as amended by T.D. 8408, 57 FR 12421, Apr. 10, 1992]

§ 1.461–3 Prepaid interest. [Reserved]

§ 1.461–4 Economic performance.

(a) *Introduction*—(1) *In general.* For purposes of determining whether an accrual basis taxpayer can treat the amount of any liability (as defined in § 1.446–1(c)(1)(ii)(B)) as incurred, the all events test is not treated as met any earlier than the taxable year in which economic performance occurs with respect to the liability.

(2) *Overview.* Paragraph (b) of this section lists exceptions to the economic performance requirement. Paragraph (c) of this section provides cross-references to the definitions of certain terms for purposes of section 461 (h) and the regulations thereunder. Paragraphs (d) through (m) of this section and § 1.461–6 provide rules for determining when economic performance occurs. Section 1.461–5 provides rules relating to an exception under which certain recurring items may be incurred for the taxable year before the year during which economic performance occurs.

(b) *Exceptions to the economic performance requirement.* Paragraph (a)(2)(iii)(B) of § 1.461–1 provides examples of liabilities that are taken into account under rules that operate without regard to the all events test (including economic performance).

(c) *Definitions.* The following cross-references identify certain terms defined for purposes of section 461(h) and the regulations thereunder:

(1) *Liability.* See paragraph (c)(1)(ii)(B)d of § 1.446–1 for the definition of ''liability.''

(2) *Payment.* See paragraph (g)(1)(ii) of this section for the definition of ''payment.''

(d) *Liabilities arising out of the provision of services, property, or the use of property*—(1) *In general.* The principles of this paragraph (d) determine when economic performance occurs with respect to liabilities arising out of the performance of services, the transfer of property, or the use of property. This paragraph (d) does not apply to liabilities described in paragraph (e) (relating to interest expense) or paragraph (g) (relating to breach of contract, workers compensation, tort, etc.) of this section. In addition, except as otherwise provided in Internal Revenue regulations, revenue procedures, or revenue rulings this paragraph (d) does not apply to amounts paid pursuant to a notional principal contract. The Commissioner may provide additional rules in regulations, revenue procedures, or revenue rulings concerning

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